BRAEGAN Energy Ltd.

The First Annual Report

1997

CORPORATE PROFILE

BRAEGAN ENERGY LTD. is a junior Canadian oil and natural gas company engaged in the production, development and exploration of petroleum and natural gas properties in the Western Canadian Sedimentary Basin. The common shares of the Corporation trade on The Alberta Stock Exchange under the trading symbol "BNE". BRAEGAN began trading on October 2, 1997, and completed its Major Transaction at a Special Shareholders' meeting held on December 23, 1997.

BRAEGAN's growth strategy is to continue to pursue production purchases and low-risk optimization opportunities until cash flow and/or equity financings enable a balanced and aggressive exploration program. BRAEGAN's management team has extensive experience in all disciplines of the oil and gas industry.

BRAEGAN ENERGY LTD. is managed by Mr. Edmund J. Marchuk, President and CEO, Mr. Robert L. Solc, Director and Mr. Ken Stickland, Director.

ANNUAL GENERAL MEETING

Shareholders are cordially invited to the Annual General Meeting on Wednesday, June 17, 1998, at 2:30 PM at the offices of Burnet, Duckworth & Palmer, Suite 1400, 350-7th Avenue, S.W., Calgary, Alberta. Shareholders who are unable to attend are requested to complete and return their Form of Proxy to Montreal Trust, 530-8th Avenue, S.W., Calgary, Alberta T2P 3S8.

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REPORT TO SHAREHOLDERS

On behalf of the Board of Directors of BRAEGAN ENERGY LTD., I am pleased to present BRAEGAN's First Annual Report as a public company.

BRAEGAN began trading as a junior capital pool with the completion of its first public offering on October 2, 1997. An asset purchase was identified quickly; a special meeting of shareholders was called and completed in timely fashion, resulting in a unanimous vote in favor of the Major Transaction on December 23, 1997, all within six months of initiating the necessary protocol to becoming a public company. The Alberta Stock Exchange recognized that Braegan Energy Ltd. is no longer considered a Junior Capital Pool Company effective January 13, 1998.

The Major Transaction consisted of purchasing four producing properties in the Willesden Green, Boundary Lake, Pembina and Princess areas of Alberta, and a Joint Venture in the Pembina area with Zargon Oil and Gas Ltd., a company with a consistent year-over-year growth record. In an increasingly competitive environment, the joint venture will enhance Braegan's ability to pursue larger capital acquisitions and prospects, as well as enabling BRAEGAN to concentrate on exploration and development, rather than on operating duties. The Pembina area is well known to management, has developed infrastructure and good multi-zone potential.

On April 21, 1998, BRAEGAN closed a producing property acquisition in the Pembina area with our Joint Venture partner, which adds 18 BOEPD net, doubling the existing production base. All oil production is light gravity crude and all gas is gathered and sold. Recompletion, development and tie-in opportunities have been identified and are presently being pursued. These low capital workovers will be initiated after spring breakup.

BRAEGAN's position of no debt, a good capital structure, and undrawn lines of credit, will enable the Company to capitalize on asset acquisitions, which we anticipate may become more available due to declining oil prices.

Our corporate strategy in 1998 is towards a balanced producing property acquisition and development program, slightly weighted to natural gas in order to increase our production and cash flow base. We will also dedicate effort to lower risk, small capital outlay exploration and development prospects. Management is committed to expanding the production and cash flow base within our core Pembina area. We are also working to establish two new core areas for the Corporation. The Sundre area and the Enchant area will be examined as potential core areas.

The present economic environment presents a challenge to BRAEGAN because of its modest capital budget. However, I remain confident in our ability to exercise quick and sound judgment to be able to capitalize on the changing opportunities that are still available.

On behalf of management, I would like to thank each shareholder for their support and the private placement subscribers for their long-term confidence. Appreciation is extended to our legal counsel and agents for their quick response in a very busy environment.

I welcome our shareholders and look forward to a successful future.

On behalf of the Board of Directors.

EDMUND J. MARCHUK
President & C.E.O.

Ed Marc

CORPORATE DEVELOPMENTS

BRAEGAN ENERGY LTD. was incorporated as 720507 Alberta Ltd. on December 10, 1996. The name of the Corporation was changed to BRAEGAN ENERGY LTD. on May 27, 1997. The Corporation was listed on The Alberta Stock Exchange on October 2, 1997, as a Junior Capital Pool, under the trading symbol "BNE".

On December 23, 1997, the shareholders of BRAEGAN approved the Major Transaction at a Special Meeting of Shareholders. In conjunction with the Major Transaction, a Private Placement of 600,000 Common Shares for gross proceeds of $300,000 was also approved. Shortly after on December 30, 1997, the Corporation closed a Flow-Through Share issue of 497,763 Common Shares for gross proceeds of $423,100 which are to be expended prior to December 31, 1998. Total outstanding shares issued amount to 5,277,763 for gross proceeds of $1,290,100.

OPERATIONS REVIEW

Although BRAEGAN's long-term objective is towards operating its properties, BRAEGAN does not currently operate any of its properties. As a start-up junior capital pool company, the revenues required to operate could not be justified.

BRAEGAN's production comes from five areas as follows:

Willesden Green

Production is from one gross well (0.19 net) completed in the Belly River group which has experienced very little decline over the last several years. We are attempting to increase our working interest and exposure in the area.

Boundary Lake

Light gravity crude is produced from four gross (1.04 net) oil wells completed in the Boundary Lake formation. Two non-producing Gething gas wells are being evaluated for possible tie-in once pooling arrangements are finalized.

Pembina

The Cardium formation produces light gravity crude from three gross wells (0.225 net) in the area. The wells are being monitored for possible workover candidates.

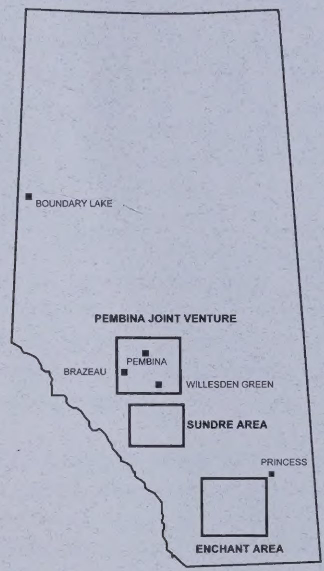
Princess

Production from one gross well (0.40 net) is from the Second White Specks sandstone to a PanAlberta contract. Possible completions in the Milk River and Medicine Hat sandstone are being evaluated.

Brazeau

The main production is light gravity crude from the Viking formation. Three gross wells (1.5 net) are shut-in presently and are being evaluated for reactivation. Two additional gross wells (1.0 net) have identified uphole potential and will be completed. The work program will be started after break up.

Areas of Activity



Our existing funds will be used only for the most economic projects and may be diverted to new more economic opportunities. Our workover and tie-in program, by being weighted towards natural gas, will take advantage of present market conditions.

The joint venture agreement covers approximately 225 townships of land in the Pembina area of Central Alberta. The 18-month agreement effective October 1, 1997, involves a 50/50 participation in all prospects that are generated, with Zargon Oil & Gas Ltd. acting as operator. Larger deals may be pursued more feasibly and access to rigs become easier because of this association with a reputable operator.

FORWARD TO 1998

In 1998, BRAEGAN will continue with its emphasis towards acquisitions with low-risk exploitation or development upside to build a stable production base from which we can enter into a balanced exploration phase. Our long-term goal is to pursue high working interests with operatorship in select focus areas.

With present market conditions, BRAEGAN intends to increase its focus to natural gas development. We expect to achieve a long-term production portfolio of approximately 70% natural gas and 30% light gravity oil.

We look forward to a productive 1998.

MANAGEMENT'S REPORT

The consolidated financial statements and other financial information in this annual report were prepared by management of BRAEGAN ENERGY LTD., reviewed by the Audit Committee and approved by the Board of Directors.

Management is responsible for the consolidated financial statements and believes that they present fairly the Company's financial condition and results of operations in conformity with accounting principles generally accepted in Canada. Where necessary, the statements include amounts based on management's informed judgements and estimates.

In fulfilling their responsibilities for safeguarding of assets, management believes that it has established appropriate systems of internal accounting control which provide reasonable assurance that the financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements.

KPMG, Chartered Accountants, appointed by the shareholders, have audited the financial statements and their report follows.

Ed Marchuk

EDMUND J. MARCHUK
President and Chief Executive Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheet of Braegan Energy Ltd. as at December 31, 1997 and the statements of operations and deficit and changes in financial position for the period from the commencement of operations on July 1, 1997 to December 31, 1997. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1997 and the results of its operations and the changes in its financial position for the period from the commencement of operations on July 1, 1997 to December 31, 1997 in accordance with generally accepted accounting principles.

KPMG

KPMG
Chartered Accountants
Calgary, Canada
March 25, 1998

BRAEGAN ENERGY LTD.

Balance Sheet

December 31, 1997

Assets

Current assets:	
Cash and term deposits	$ 484,109
Accounts receivable	31,798
	515,907
Petroleum and natural gas properties (note 2)	663,645
	$ 1,179,552

Liabilities and Shareholders' Equity

Current liabilities:	
Accounts payable and accrued liabilities	$ 52,345
Shareholders' equity:	
Share capital (note 3)	1,166,255
Deficit	(39,048)
	1,127,207
Commitments (note 8)	
Subsequent events (note 9)	
	$ 1,179,552

See accompanying notes to financial statements.

On behalf of the Board:

Director

Director

BRAEGAN ENERGY LTD.

Statement of Operations and Deficit

For the period from the commencement of operations on July 1, 1997 to December 31, 1997

Revenue:		
Oil and gas sales, net of royalties	$	9,452
Interest		4,892
		14,344
Expenses:		
Production		1,104
General and administrative		48,498
Depreciation and depletion		3,790
		53,392
Net loss and deficit, end of period	$	39,048
Net loss per share	$	0.02

See accompanying notes to financial statements.

BRAEGAN ENERGY LTD.

Statement of Changes in Financial Position

For the period from the commencement of operations on July 1, 1997 to December 31, 1997

Cash provided by (used in):		
Operations:		
Net loss	$	(39,048)
Item not involving cash:		
Depreciation and depletion		3,790
Change in non-cash working capital		20,547
		(14,711)
Investing:		
Petroleum natural gas properties		(667,435)
Financing:		
Issuance of common shares		1,290,100
Share issuance costs		(123,845)
		1,166,255
Cash and term deposits, end of period	$	484,109

See accompanying notes to financial statements.

General:

The Corporation was incorporated on December 10, 1996 by Articles of Incorporation under the *Business Corporations Act* (Alberta) as 720507 Alberta Ltd. By Articles of Amendment dated May 27, 1997, the Corporation changed its name to Braegan Energy Ltd. The principal business activity of the Company is the exploration, development and production of petroleum and natural gas reserves and commenced operations on July 1, 1997.

1. Significant accounting policies:

(a) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas properties whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized and accumulated in a single cost centre representing the Company's activity undertaken exclusively in Canada. Such costs include land acquisition costs, geological and geophysical expenses, lease rental costs on non-producing properties, costs of drilling both productive and non-productive wells, related production equipment costs, and overhead charges directly related to these activities.

The provision for depletion and depreciation is determined on the unit-of-production method based on the estimated gross proven reserves as determined by independent engineers. Petroleum and natural gas reserves and production are converted into equivalent units based upon relative energy content. Costs associated with the acquisition and evaluation of significant unproved properties are excluded from amounts subject to depletion until such time as the properties are proved or become impaired.

The capitalized costs less accumulated depletion and depreciation are limited to an amount equal to the estimated future net revenue from proven reserves (based on prices and costs at the balance sheet date) plus the unimpaired costs of non-producing properties less estimated future administrative expenses, development costs, financing costs, income taxes and estimated future abandonment and site restoration costs.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Estimated future abandonment and site restoration costs are provided for over the life of the proven reserves on a unit-of-production basis. Actual abandonment and site restoration expenditures are charged to the accrued liability account as incurred.

1. **Significant accounting policies:**

(a) Petroleum and natural gas properties (continued):

Substantially all of the exploration and production activities of the Company are conducted jointly with others and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Depreciation of office equipment is provided for over the estimated useful lives of the assets at a rate of 30% per annum using the declining balance method.

(b) Per share data:

Per share data has been calculated using the weighted average number of common shares outstanding during the period.

(c) Flow-through shares:

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are made.

(d) Measurement uncertainty:

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and the provision for future site restoration costs are based on estimates. The cost ceiling is based on such factors as estimated proved reserves, production rates, oil and natural gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and may impact the financial statements of future periods.

2. **Petroleum and natural gas properties:**

	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties	$ 654,000	$ 1,775	$ 652,225
Office equipment	13,435	2,015	11,420
	$ 667,435	$ 3,790	$ 663,645

3. Share capital:

(a) Authorized:

Unlimited number of voting common shares

Unlimited number of first preferred shares

Unlimited number of second preferred shares

(b) Issued:

Common Shares

	Number of Shares	Amount
Issued for cash	4,600,000	$ 800,000
Issued through property acquisition	150,000	75,000
Flow-through shares, net of tax effect of $14,000	497,763	409,100
Issued for cash, on exercise of options	30,000	6,000
Share issue costs	–	(123,845)
Balance, December 31, 1997	5,277,763	$1,166,255

(c) Pursuant to an Employee Stock Option Plan, the Company has outstanding options to purchase 537,500 common shares of the Company exercisable at prices ranging from $.20 to $.50 per common share.

Of these options, 200,000 options vest over a period of three years on the basis of one-third per year from the date of granting. The remaining 200,000 options vest on a performance basis such that 100,000 of such options will vest upon the Corporation achieving a production target of 500 barrels of oil equivalent per day with the remaining 100,000 options vesting upon the Corporation reaching a production target of 1,000 barrels of oil equivalent per day (sales), in each case on the basis of a 10:1 conversion ratio for gas to oil and subject to the requirement that these options do not vest until the expiration of the twelve months from the date of granting.

(d) In connection with the Company's initial public offering, the Company has granted to the agent an option to purchase 100,000 common shares at a price of $0.20 per share, expiring 18 months after the Company's listing date of October 2, 1997. Options to purchase 70,000 common shares remain outstanding at December 31, 1997.

(e) In connection with the Company's offering of flow-through common shares, the Company has offered the agent warrants to acquire 39,821 common shares of the Company at a price of $0.85 per common share. These warrants expire December 31, 1998.

4. **Income taxes:**

The provision for income taxes in the statement of operations reflects an effective income tax rate which differs from combined federal and provincial statutory tax rates. The main differences are summarized as follows:

Loss before income taxes	$ 39,048
Corporate income tax rate	45%
Computed expected income tax provision (recovery)	(17,600)
Increases resulting from:	
Non-deductible crown payments, net	150
Unrecognized benefit of loss carry-forward	17,450
Provision for income taxes	$ –

5. **Credit facility:**

The Company has arranged for a $150,000 line of credit from a company controlled by a director of the Company, at bank prime rate plus 2% per annum which is secured by a floating charge on the assets of the Company. The line of credit has not been utilized to date.

6. **Related party transactions:**

During the year, the Company paid for geological services provided by company controlled by a director totalling $30,000.

7. **Fair values:**

The fair values of the Company's monetary assets and liabilities approximate their carrying values at December 31, 1997.

8. **Commitments:**

The Company is committed to pay minimum lease payments for computer software and office premises of the following amounts:

1998	$ 34,420
1999	$ 13,883

9. **Subsequent events:**

On March 3, 1998, the Company entered into a letter of intent to acquire interests in certain petroleum and natural gas properties, for cash consideration of $220,000.

CORPORATE INFORMATION

BOARD OF DIRECTORS

Edmund J. Marchuk
Calgary, Alberta

Robert L. Solc
Calgary, Alberta

Ken Stickland
Calgary, Alberta

OFFICERS & KEY PERSONNEL

Edmund J. Marchuk, P.Geol.
President, CEO

Robert L. Solc, P.Eng.
Director

Deborah L. Solc, P.Geol.
Geologist

Avelaine Barcelo
Office Manager

SOLICITORS

Burnet, Duckworth & Palmer
Suite 1400, 350-7th Avenue, SW
Calgary, Alberta T2P 3N9

BANKERS

National Bank of Canada
401-8th Avenue, SW
Calgary, Alberta T2P 1E3

REGISTRAR & TRANSFER AGENT

Montreal Trust
530-8th Avenue, SW
Calgary, Alberta T2P 3S8

AUDITORS

KPMG
1000, 205 5th Avenue, SW
Calgary Alberta T2P 4B9

TRADING JURISDICTION

The Alberta Stock Exchange

Trading Symbol: BNE

CORPORATE OFFICE

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